IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF IOWA

In the Matter of:
LBI, **Case No. 16-01125-als7**

Debtor(s)

Charles L Smith, **Adv. Pro. 17-30033-als**

Plaintiff(s)

v.

RDD Accounting Services, LLC,
Timothy Hogan,

Defendant(s)

MEMORANDUM OF DECISION
(date entered on docket: September 27, 2017)

Before the Court is Defendant's Motion for Summary Judgment and the Plaintiff's objection to that relief. The Court has jurisdiction of this matter under 28 U.S.C. § 1334, 11 U.S.C. § 522, and Fed. R. Bankr. P. 4003. The Court canceled the hearing on the Motion and took the matter under advisement on the filed documents.

BACKGROUND

1. Liberty Bank, F.S.B.

LBI, Inc., (formerly known as Iowa Banshares, Inc.) (LBI)[1] is an Iowa corporation and registered savings and loan holding company. It is the sole shareholder of Liberty Bank ("Bank"), a federal savings bank that conducted business in Iowa.

On December 28, 2009, LBI entered into a Secured Loan Agreement ("Loan Agreement") to borrow money under Secured Term Notes from a variety of unnamed lenders that would later be identified by executing joinder agreements. LBI collateralized these loans under a Stock Pledge

[1] Banshares, Inc. changed its name to LBI in 2014. For ease of reference the name LBI will be utilized throughout this ruling to identify both entities.

Agreement ("Stock Pledge") which provided that a non-fiduciary administrative agent would hold LBI's Bank's shares on behalf of all of LBI's Lenders for their mutual benefit. RDD, as the current administrative agent, holds a security interest in the LBI's "Bank Stock." The exhibits reflect that a number of individuals and entities loaned approximately $10 million under this arrangement.

In late June 2011 with the Lenders' consent, LBI and RDD entered into an Amended and Restated Secured Loan Agreement and An Amended and Restated Stock Pledge Agreement. Under these new agreements, LBI issued $12,000,000 of additional promissory notes and also authorized LBI to issue payment-in-kind notes ("PIK notes") to the Lenders in lieu of cash interest payments. These PIK notes were collateralized under the Restated Stock Pledge on a *parri parsu* basis with the original notes.

On December 17, 2013 the Bank proposed a Plan of Voluntary Dissolution ("Plan") that would create a liquidating trust to satisfy the Bank's obligations. The Office of the Comptroller of the Currency approved this plan. The Bank and Timothy Hogan, the designated Trustee, then created the Liberty Bank Liquidation Trust ("Trust" or "Trust Agreement").

2. Bankruptcy

LBI filed a voluntary petition under chapter 7 on May 27, 2016. Charles Smith was appointed trustee in the bankruptcy case. In addition to a minimal amount of cash, the only other asset identified on the schedules is LBI's beneficial interest in the Trust valued at $1,477,759.

3. *Smith v. RDD Accounting, LLC; Timothy Hogan, Trustee.*

On May 17, 2017 Smith filed this adversary proceeding. Count I of Smith's complaint requests a determination of the validity, priority and extent of the security interest granted by the Stock Pledge in LBI's beneficial interest in the Trust.[2]

RDD contends that a determination of two narrow issues demonstrate its entitlement to summary judgment in this case: 1) because LBI cannot compel the Trustee to make a distribution, neither can Smith as its bankruptcy trustee; and 2) LBI's beneficial interest in the Trust represent proceeds of the stock that are subject to RDD's security interest. Smith disputes these grounds for summary judgment.

DISCUSSION

Bankruptcy Rule 7056 which incorporates Federal Rule of Civil Procedure 56 applies to the Motion for Summary Judgment. Rule 56 states, in relevant part:

2 Counts II and III of Smith's complaint seek turnover of the funds that remain in the Trust and an accounting of the Trust's activities. Neither of these Counts are at issue in the pending Motion.

> (a) The court shall grant summary judgment if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law.
>
> (c)(1) A party asserting that a fact cannot be or is genuinely disputed must support the assertion by:
> (A) citing to particular parts of materials in the record, including depositions, documents, electronically stored information, affidavits or declarations, stipulations (including those made for purposes of the motion only), admissions, interrogatory answers, or other materials; or
> (B) showing that the materials cited do not establish the absence or presence of a genuine dispute, or that an adverse party cannot produce admissible evidence to support the fact.

Summary judgment is appropriate "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue of material fact and that the moving party is entitled to judgment as a matter of law." *Celotex v. Catrett*, 477 U.S. 317, 322 (1986). Once the moving party has met its burden of showing both the absence of a genuine issue of material fact and its entitlement to judgment as a matter of law, the burden shifts to the non-moving party to set forth specific facts to show that "a genuine issue of material fact exists." *N. Am. Specialty Inc. Co. v. Thomas (In re Thomas)*, Bankr. No. 08-42854, 2010 U.S. Dist. LEXIS 16269, at *8 (Bankr. E.D. Mo. 2010).

The analysis under Rule 56 is two-part. First, whether there is "a genuine dispute of material fact – i.e., a triable issue as to a fact necessary to satisfy an essential element of the claim or defense in question, under the governing law." *Community Finance Group, Inc. v. Fields (In re Fields*), 449 B.R. 387, 391 (Bankr. D. Minn 2011). Second, "only if there is no genuine dispute of material fact, [whether] the governing law dictate[s] judgment for the movant on the facts thus established as uncontroverted." *Id.*

RDD suggests that it is entitled to receive funds directly from the Trust based upon its security interest. RDD does not address the initial and fundamental question of whether the beneficial interest is property of the bankruptcy estate. The Bankruptcy Code broadly defines property of the estate as "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. §541(a)(1). There are very few exceptions to this definition. One such exception is a restriction on the transfer of a beneficial interest, such as a spendthrift trust. 11 U.S.C. §541(c)(2). Even that restriction, however, is not dispositive of the issue. "[T]he exclusion of property from the bankruptcy estate under § 541(c)(2) is permissive rather than mandatory." *Scott v. King (In re Amerson)*, 839 F.3d 1290, 1299 (10th Cir. 2016), *petition for cert. filed*, 2015 Bankr. LEXIS 2930 (B.A.P. 10th Cir. Sept. 2, 2015) (Bank.

No. 15-01343) (emphasis omitted). There is no spendthrift provision in the Trust Agreement that would permit exclusion of the beneficial interest as property of the estate. Additionally, the Trust Agreement clearly states: "The Shareholder, as the sole shareholder of Liberty Bank as of the date hereof, *owns* the Beneficial Interest." (emphasis added) LBI identified its beneficial interest as an asset on the bankruptcy schedules filed with the Court. Moreover, RDD has not shown that classifying the beneficial interest as property of the estate is the equivalent of a Trust "distribution."

Whether the beneficial interest is subject to a lien or has been properly secured is a separate issue. *See Bayview Loan Servicing, LLC, et al. v. Gold (In re McClaren*), 562 B.R. 309, 319 (Bankr. E.D. Virginia 2016). Smith's complaint calls into question RDD's lien as follows: 1) its validity which relates to "the existence or legitimacy of the lien itself;" 2) its priority which involves "the lien's relationship to other claims or interest in the collateral;" and 3) its extent which means "the scope of the property encompassed by or subject to the lien". *In re Millspaugh*, 302 B.R. 90, 96 (Bankr. D. Idaho 2003), quoting *In re King,* 290 B.R. 641, 648 (Bankr. C. D. Ill. 2003); see also *In re Hoskins,* 262 B.R. 693, 696–97 (Bankr. E. D.Mich.2001); *In re Hudson,* 260 B.R. 421, 433 (Bankr.W. D. Mich. 2001); 10 Collier ¶¶ 7001.03[1], 7001.03[2], at 7001–10 to 7001–13.

The Trust's primary purpose was to "receive the Assets from Liberty Bank . . . to collect and distribute proceeds of the Trust estate and <u>first</u>, to provide for the payment of, or provision for, the Liabilities of Liberty Bank (to the extent of the Trust Estate), and <u>second</u>, upon termination of the Trust, to distribute the remainder of the Trust Estate to the Shareholder, as the holder of the Beneficial Interest in the Trust Estate (emphasis original).

The Trust Agreement clearly recognizes that LBI owns the beneficial interest of the Trust. It also acknowledges that RDD "holds a security interest in the Bank's stock owned by LBI to secure LBI's obligations" to its Lenders. The Trust Agreement then goes on, however, to state that "Pursuant to the Stock Pledge Agreement the Administrative Agent holds a security interest in the Beneficial Interest as proceeds of the Stock." Only the Bank and Hogan as Trustee executed the Trust Agreement—LBI did not sign the Trust Agreement. RDD has provided no facts to establish that either the Bank or the Trustee had the legal authority, or LBI's consent, to extend its stock pledge to its beneficial interest in the Trust.

Each of the legal authorities cited in support of RDD's argument that the beneficial interest in the Trust represents proceeds of the Bank Stock will be addressed. RDD cites to *McGonigle v. Combs* as standing for the proposition that the beneficial interest in the Trust represents proceeds of the LBI's Bank Stock. *See* 968 F.2d 810 (9th Cir. 1992). The facts in that case are different from those present here. There the lenders alleged a diminution in the value of the stock as the injury warranting damages. *Id.* at 828-29. The Ninth Circuit held that in such a situation the lenders were entitled to a "lien", not a security interest, which did not result in rights superior to any other creditors. *Id.* *McGonigle* is not

dispositive of the validity, priority and extent of RDD's lien vis-à-vis the bankruptcy estate's interest in LBI's beneficial interest in the Trust.

RDD points to the broad definitions of proceeds and accounts under Iowa's Uniform Commercial Code in support of its proceeds argument.

Statutory interpretation begins with the language of the statute itself. *Green Tree Servicing, LLC v. Coleman (In re Coleman)*, 392 B.R. 767, 770 (B.A.P. 8th Cir. 2008). We "presume that [the] legislature says in a statute what it means and means in a statute what it says there." *Conn. Nat'l Bank v. Germain*, 503 U.S. 249, 253–54 (1992). When a court finds that a statute's plain meaning is unambiguous, "judicial inquiry is complete." *Rubin v. United States*, 449 U.S. 424, 430 (1981). "[I]n the absence of 'a clearly expressed legislative intent to the contrary, that language must ordinarily be regarded as conclusive.'" *Russello v. United States*, 464 U.S. 16, 20 (1983), quoting *United States v. Turkette*, 452 U.S. 576, 580 (1981). The Court analyzes the following code provisions using these principles.

Iowa Code § 554.9102(1)(bl) defines proceeds as:

> (1) whatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral;
> (2) whatever is collected on, or distributed on account of, collateral;
> (3) rights arising out of collateral;
> (4) to the extent of the value of collateral, claims arising out of the loss, nonconformity, or interference with the use of, defects or infringement of rights in, or damage to, the collateral; or
> (5) to the extent of the value of collateral and to the extent payable to the debtor or the secured party, insurance payable by reason of the loss or nonconformity of, defects or infringement of rights in, or damage to, the collateral.

The statutory language of Iowa Code § 554.9102(1)(b) states in relevant part that an:

> "*Account*" . . . means a right to payment of a monetary obligation . . . for property has been or is to be sold, leased, licensed, assigned or other otherwise disposed of . . . . The term does not include rights to payment evidenced by chattel paper or an instrument, commercial tort claims, deposit accounts, investment property, letter-of-credit right or letters of credit, or rights to payment for money or funds advanced or sold, other than rights arising out of the use of a creditor or charge card or information contained on or for use with the card.

To adopt RDD's reasoning at this juncture of the case would require an interpretation of these unambiguous statutes beyond their plain meaning. Other courts have construed the same statutory language and found that "in order for rights to 'arise out of collateral,' [proceeds] must have been obtained as a result of some loss or dispossession of the party's interest in that collateral." *1st Source*

Bank v. Wilson Bank & Tr., 735 F.3d 500, 504 (6th Cir. 2013) (collecting cases finding that "revenues earned through the use of collateral are not proceeds"); *see also Kingsley v. First Am. Bank of Casselton (In re Kingsley)*, 865 F.2d 975, 980 (8th Cir. 1989) (rejecting argument that government crop payment were proceeds of crops because "they were not were not received . . . upon the sale, exchange or other disposition of their . . . crops"). Closer to the facts of this case, "The fact that the owner of stock is included in financial transactions that yield the owner a money return does not make such benefits proceeds within the meaning of a security agreement covering the shares of stock and their proceeds." § 9-306:24 Breadth of the term "proceeds", 9 Anderson U.C.C. § 9-306:24 (3d. ed.).

For the reasons stated, RDD has failed to establish that it is entitled to judgment as a matter of law and it is therefore ORDERED that: The Motion for Summary Judgment is denied.

/s/ Anita L. Shodeen
Anita L. Shodeen
U.S. Bankruptcy Judge

Parties receiving this Memorandum of Decision from the Clerk of Court:
Electronic Filers in this Adversary Proceeding